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No. 04-487

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

PETER S. VISNIC, MICHAEL GRYNBERG, LEROY HIBBITTS, SAJID KALEEM and PHILIP WEISBURGH, IRA,

Petitioners,

v.

NORTEL NETWORKS CORPORATION, JOHN ANDREW ROTH, WILLIAM F. CONNOR, CHAHRAM BOLOURI and FRANK DUNN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether, under the private right of action implied by Section 10(b) and Rule 10b-5, shareholders of a public company have standing to sue another, unaffiliated issuer for securities fraud when the shareholders were neither purchasers nor sellers of that issuer's securities.

RULE 14.1 AND RULE 29.6 STATEMENT

The petition correctly lists the parties in the Court of Appeals.

Respondent Nortel Networks Corporation ("Nortel") is a publicly held corporation whose common shares are traded on the New York Stock Exchange and the Toronto Stock Exchange. Nortel is not a subsidiary of any parent company whose shares are publicly traded. In addition, securities issued by Nortel Networks Limited, a subsidiary company of Nortel, are traded on the Toronto Stock Exchange. No publicly held company owns 10 percent or more of the common shares of Nortel Networks Corporation.

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STATEMENT OF THE CASE

Plaintiffs put forth a vision of universal securities law standing. They argue that even though they never purchased or sold a single share of the securities of the issuer that ostensibly made false statements about its own financial condition and operations, they nonetheless have standing to sue as long as they purchased "any" security upon which the issuer's statements had some impact. Thus, a corporation can be sued not only by its own security holders, but also by shareholders of its suppliers, its customers, its banks, and even its competitors, provided that those shareholders allege that the offending corporation's statements impacted the trading price of those other companies' securities.

The Second Circuit's ruling rejecting universal standing and affirming the District Court's dismissal of plaintiffs' securities law claims comports both with this Court's well-established jurisprudence and the pertinent statutory language, and is wholly consistent with the only other Court of Appeals decision that touches on this issue. There is no reason for this Court to revisit a ruling so firmly grounded in bedrock principles of securities law.

A. Plaintiffs' Allegations

Nortel Networks Corporation ("Nortel") is a supplier of global telecommunications services. App. 3a.[1] JDS Uniphase Corporation ("JDSU") manufactures fiber optic components for sale to Nortel and other companies. App. 3a. Plaintiffs are purchasers of the common stock of JDSU. They never purchased or sold Nortel common stock. App. 5a.

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[1] Citations to the Appendix ("App.") are to those materials appended to Petitioners' Petition for Writ of Certiorari ("Pet.").

On January 16, 2001, it was reported that Nortel and JDSU were close to consummating a transaction whereby Nortel would purchase JDSU's laser business in exchange for $2.5 billion of Nortel common stock. App. 4a. The transaction between Nortel and JDSU closed on February 12, 2001. App. 4a.

Between January 18, 2001 and February 15, 2001, Nortel made public statements that it saw strong demand for Nortel's fiber optics products and expected 30% growth in revenue and earnings in 2001. App. 4a. On February 15, 2001, however, Nortel announced that it was reducing its revenue growth projections from 30% to 15% and its revenue estimates by $1.7 billion. The market price of both Nortel and JDSU common stock declined following this announcement. App. 4a. Plaintiffs allege that the financial statements and press releases that Nortel made between January 18, 2001 and February 15, 2001 were materially misleading. App. 4a.

Following Nortel's revised guidance announcement on February 15, 2001, Nortel's stock price plummeted and, predictably, class action lawyers representing Nortel shareholders immediately began filing class action lawsuits against Nortel pursuant to Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. App. 5a. The Nortel shareholder lawsuits were consolidated and that case is currently being litigated. App. 5a.

Shortly after Nortel's February 15 announcement, however, there was an unprecedented additional development: on March 7, 2001, five individuals separately filed their own securities fraud actions against Nortel, ostensibly on behalf of a class of persons that purchased not Nortel securities but rather the common shares of JDSU (the "JDSU

Complaint"). App. 5a. The JDSU Complaint substantially tracks the complaint filed by Nortel shareholders, with the added twist that Nortel's fraud is alleged not only to have inflated Nortel stock, but JDSU's stock as well.

B. The District Court Proceedings

Nortel moved to dismiss the JDSU Complaint pursuant to Fed. R. Civ. P. 12(b)(6) for lack of standing and for failure to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. App. 5a. On January 3, 2003, the United States District Court for the Southern District of New York granted Nortel's motion and dismissed the JDSU Complaint with prejudice. App. 5a. The District Court, applying *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), held that shareholders of JDSU lacked standing to maintain a cause of action against Nortel because they had not purchased or sold a single share of Nortel stock. App. 5a. The District Court also dismissed the JDSU Complaint on the independently sufficient ground that plaintiffs could not, as a matter of law, satisfy the "in connection with" requirement because Nortel did not make any statement concerning JDSU. App. 5a. In dismissing the JDSU Complaint, the District Court rejected plaintiffs' theory of universal standing for any plaintiff who acquired some security and alleged that statements by an unrelated company had some impact on the trading price of that security.

C. The Second Circuit Proceedings

The Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the JDSU Complaint with

prejudice on the ground that plaintiffs lack standing to maintain a cause of action under Section 10(b) and Rule 10b-5. App. 2a. The Second Circuit's opinion was guided by the principle that "the private right of action [under Section 10(b) and Rule 10b-5] is not unlimited." App. 7a. The Second Circuit considered and rejected plaintiffs' argument that universal standing exists whenever a plaintiff purchases "'*any security*' [which] includes securities of any company affected in some way by the misrepresentation and not just securities of the company that makes the material misstatements." App. 9a (emphasis added). The Second Circuit stated that plaintiffs' interpretation would subvert the purchaser-seller requirement established by this Court in *Blue Chip*, which "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." App. 10a (citing *Blue Chip*, 421 U.S. at 747).

The Second Circuit further concluded that this Court's concern, reflected in *Blue Chip*, that granting overbroad standing would "encourage individuals to engage in potentially abusive litigation" is particularly compelling here, where plaintiffs never purchased the security of the offending issuer. App. 10a. Based on this Court's standing jurisprudence and the relevant statutory language, and after considering (and distinguishing) purportedly conflicting Third Circuit precedent, the Second Circuit concluded that "[s]tockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they did not purchase." App. 13a. Plaintiffs' petition to the Second Circuit for rehearing by the panel or *en banc* was denied.

REASONS FOR DENYING THE WRIT

The Second Circuit's decision affirming dismissal of the JDSU Complaint for lack of standing (the "Opinion") is founded upon sound law and prudent policy. For almost 30 years since this Court's decision in *Blue Chip*, the private right of action created by Section 10(b) and Rule 10b-5 "limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." 421 U.S. at 747. The decision below represents a straightforward application of this principle and the rejection of the notion of open-ended, universal standing. Plaintiffs' conjectural (and exaggerated) concerns about hypothetical plaintiffs being unjustly deprived of standing can be safely ignored.

I. The Second Circuit's Ruling Is Consistent With This Court's Jurisprudence and the Statutory Language

Although plaintiffs seek to characterize the Second Circuit's ruling as unprecedented, the Opinion is in fact fully consistent with this Court's venerable standing jurisprudence. Indeed, it is plaintiffs' own excessive theory of standing that is aberrant. This Court repudiated plaintiffs' expansive theory of Section 10(b) standing decades ago in *Blue Chip*. Plaintiffs have not provided (and cannot provide) this Court with any compelling justification for revisiting that decision. This is especially so where the Second Circuit correctly applied *Blue Chip* to preclude plaintiffs from suing Nortel where:

- Nortel only made statements about its own operations and financial condition;

- Plaintiffs did not purchase Nortel stock and only purchased JDSU stock;
- Nortel is not alleged to have directed any misrepresentations to JDSU shareholders; and
- Nortel was not affiliated with JDSU and made no tender offer to purchase JDSU shares from JDSU's shareholders.

These collective facts place this case squarely within the scope of this Court's *Blue Chip* decision. Plaintiffs seek to interpret *Blue Chip* broadly to create standing for any plaintiff that engages "in the mere act of purchasing or selling securities." Pet. at 8. Under plaintiffs' novel theory, the purchaser of *any* security would be entitled to sue *any* company.

Blue Chip forecloses the theory plaintiffs propose. In *Blue Chip*, this Court affirmed the purchaser-seller standing requirement first articulated by the Second Circuit in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952).[2] This Court held that persons who did not actually buy or sell securities (but rather claimed they chose not to buy because of deliberately false negative statements about a company) did not have standing to sue. To secure standing, a plaintiff must have bought or sold the security "in question," that is, the security to which the misrepresentation "relates":

> The virtue of the *Birnbaum* rule, simply stated, in this situation, is that it limits the class of plain-

[2] The standing requirement stems from the provision of Rule 10b-5 that a fraud or deceit must be "in connection with the *purchase or sale* of any security" (emphasis added).

> tiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates.

Blue Chip, 421 U.S. at 747.[3] The Second Circuit's ruling appropriately construes this passage to require that plaintiffs actually buy or sell the security to which the misrepresentation "relates"—here, Nortel (not JDSU) stock. This is also entirely consistent with this Court's unqualified statement elsewhere in *Blue Chip* that the *Birnbaum* rule "permits exclusion prior to trial of those plaintiffs who were not themselves purchasers or sellers of the stock in question." *Id.* at 742. The JDSU plaintiffs fall squarely into the category of such excluded nonpurchasers.

Plaintiffs' argument that the Opinion is inconsistent with the policies and principles established by this Court in *Basic Inc. v. Levinson,* 485 U.S. 224 (1988) (Pet. at 15-16), is also without merit. Both *Blue Chip* and the Opinion address the threshold issue of which stock purchasers have standing to bring a claim under the federal securities laws. *Basic*, in contrast, deals with the standard for pleading the reliance element of a Rule 10b-5 claim, an issue that arises only after a court has determined that the plaintiff has

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[3] Plaintiffs' denigration of this statement in *Blue Chip* as *dicta* (Pet. at 12)—and thus unauthoritative—is groundless. This Court's *Blue Chip* decision has much broader reach than the mere resolution of unique facts involved in that one case. Rather, the *Blue Chip* standing requirements are *always* a prerequisite to prosecution of a private securities claim. *See Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 277 (1992) (O'Connor, J., concurring) ("in *Blue Chip*, . . . we confirmed the federal courts' 'longstanding acceptance' of the rule that a plaintiff must have actually purchased or sold the securities at issue in order to bring a Rule 10b-5 private damages action") (citations omitted).

standing to bring a claim in the first place. Where, as here, plaintiffs lack standing to maintain a private right of action, whether they can sufficiently allege reliance as an element of their claim is beside the point.

After concluding that plaintiffs lack standing, the Second Circuit declined to reach the independent issue of whether plaintiffs could satisfy the "in connection with" requirement of a securities claim.[4] Despite the fact that the Second Circuit expressly did not reach the issue, plaintiffs boldly assert that the Opinion somehow "undermines an extensive body of Supreme Court and circuit court precedent interpreting" this component of Rule 10b-5. This extravagant assertion—based on out-of-context snippets of case law—is, like plaintiffs' standing argument, totally unfounded.

As is the case with plaintiffs' theory of universal standing, to accept their view of the "in connection with" requirement is to construe the securities laws as boundless. Under such a grandiose theory, different groups of plaintiffs who invested in different companies can all sue an unrelated issuer for securities fraud consistent with the "in connection with" requirement, provided that each plaintiff merely alleges that the issuer's statements—directly or indirectly, intentionally or unintentionally—had a "materi-

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[4] The District Court *did* reach the "in connection with" issue and concluded that, because Nortel had made no statement to JDSU shareholders or about JDSU, the "[requisite] connection [under Rule 10b-5] does not exist where, as here, the plaintiff does not allege that the defendant 'misled him concerning the value of the securities he [actually bought or] sold or the consideration he received in return.'" App. 29a (quoting *Saxe v. E.F. Hutton & Co.*, 789 F.2d 105, 108 (2d Cir. 1986)). Thus, the Second Circuit declined to reach an issue that the District Court had decided adversely to the plaintiffs.

al" impact on his company's stock price. Under the law, that result is untenable.

Clearly, courts within the Second Circuit (and elsewhere) have consistently interpreted the "in connection with" test so as to apply to misrepresentations that relate intentionally and directly to the securities bought and sold by the plaintiffs. *See, e.g., Pross v. Katz,* 784 F.2d 455, 459 (2d Cir. 1986) ("[T]he fraud alleged [must be] 'integral to the purchase and sale of the securities in question.'") (citation omitted); *Saxe v. E.F. Hutton & Co.,* 789 F.2d 105, 108 (2d Cir. 1986) (affirming dismissal of Section 10(b) claim because the alleged misrepresentations did not "concern[] the value of the securities he sold or the consideration he received in return"). That requisite connection between the alleged misrepresentations and JDSU stock is simply absent here.

Furthermore, despite plaintiffs' attempt to argue that the "in connection with" test is infinitely malleable, that requirement is not met simply by the mere allegation of materiality or impact unless a direct nexus between the defendant company and the plaintiffs is shown. For example, statements by a competitor about its own operations can impact an entire market segment. Yet no one has ever seriously suggested that another company's shareholders can sue that competitor for securities fraud. *See, e.g., Gershon v. Wal-Mart Stores Inc.,* 910 F. Supp. 128, 132 (S.D.N.Y. 1995) ("in connection with" requirement not satisfied in absence of nexus between defendant and market for plaintiffs' company's stock; "[t]he reach of Rule 10b-5 is not so extensive as to grasp all actors whose behavior has a negative impact on the market price of an issuer's securities").

The remedial purposes of Section 10(b) simply do not justify the highly attenuated and open-ended interpretations of standing and injury that plaintiffs urge this Court to adopt. *No* case has construed the "in connection with" requirement to permit a limitless array of claims based upon plaintiffs' assertion that an unrelated issuer's statements about itself had some material impact on their company's stock price.[5]

Finally, the Second Circuit appropriately rejected the strained argument that the phrase "any security" in Section 10(b) refers to "any company's securities." Rather, the phrase means "all types of securities," *i.e.*, stocks, bonds and debentures, as well as unregistered securities. App. 9a-10a.[6] The Second Circuit's sensible and straightforward ruling—that purchasers of the securities of one company have no standing to sue an unrelated company for alleged misstatements about itself—does not merit review.

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[5] Plaintiffs exploit generic language from inapposite cases to prop up their otherwise insupportable argument. For example, plaintiffs rely upon *SEC v. Zandford*, 535 U.S. 813 (2002), which permitted the Securities and Exchange Commission to enforce Section 10(b) against a securities broker who sold his client's securities and stole the proceeds. Obviously, *Zandford* involved facts and legal issues having nothing to do with this case. Indeed, with respect to effectuating Section 10(b)'s remedial purposes, parties with a direct action against Nortel—*i.e.*, Nortel shareholders—are already pursuing claims against Nortel.

[6] Although plaintiffs struggle to justify their creative reading of the statutory language, they acknowledge that the treatise the Opinion cites directly supports the Second Circuit's construction of that language. Pet. at 16.

II. The Second Circuit's Ruling Creates No Conflict With Any Other Court of Appeals

As an alternative basis for this Court's review, plaintiffs attempt to manufacture a conflict between the Opinion and the Third Circuit's decision in *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000). Any such conflict is illusory.

As the Opinion explains, *Cendant* addresses a securities fraud claim within the context of a tender offer. App. 11a. The plaintiffs in *Cendant* purchased shares of a target company, after Cendant made a tender offer for the target company. App. 11a. Before the merger was completed, Cendant was forced to restate its financial statements and withdrew from the transaction. App. 11a. The target company's stock price fell, and plaintiffs (shareholders of the ultimately unacquired target) sued Cendant. App. 11a. After the district court dismissed the complaint, the Third Circuit remanded with instructions to evaluate whether the complaint met the "in connection with" requirement of a Rule 10b-5 claim. 223 F.3d at 178.

The Second Circuit's ruling that plaintiffs here lack standing cannot possibly be in conflict with *Cendant* because—as the Second Circuit itself noted—*Cendant* does not even address the standing issue. This hardly qualifies as a direct conflict. *See Bunting v. Mellen*, 124 S. Ct. 1750, 1752-53 (2004) (Stevens, J.).

Moreover, there is no conflict at all. The Second Circuit left "for another day" the question of whether *Cendant* was rightly decided in its interpretation of the "in connection with" requirement in the case of a merger. App. 12a. But, on the facts of this case, the court found that *Cendant* "is

easily distinguishable." App. 12a. Cendant had made a direct tender offer to purchase the target company's shares, and the Third Circuit remanded for consideration of whether this connection satisfied the "in connection with" requirement. By comparison, this case involves no tender offer, no offer to purchase, and no similar transaction that might provide, in the Second Circuit's words, a "direct relationship" that might satisfy the "in connection with" test. App. 12a.

In short, as the courts below concluded, persuasive authority is invisible to support an effort to stretch the definition of "in connection with" to reach a different company that made statements only about itself, had no interaction with plaintiffs,[7] and had neither intent nor reason to influence their company's stock price.

III. The Second Circuit's Ruling Will Deprive No Legitimate Plaintiff of Standing

Plaintiffs seek to justify the grant of certiorari by presenting a parade of unwelcome consequences that might be generated by the Second Circuit's ruling. Plaintiffs forecast that the Opinion will improperly bar numerous purchasers of stock from bringing lawsuits to impose Rule 10b-5 liability against various third parties that may have contributed to alleged fraud, as well as undermine the very integrity of the market. Pet. at 8. Plaintiffs' alarmist concerns are wholly unfounded.

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[7] To the extent that JDSU might be construed as having "purchased" Nortel's shares in selling its optical unit, that arguably afforded direct standing to JDSU, not its shareholders. JDSU, however, has not sued Nortel. JDSU's shareholders at most have a derivative claim against JDSU regarding its failure to sue Nortel, not a direct claim against the latter. App. 29a.

The simple fact is that the JDSU plaintiffs did not purchase shares of the stock about which the allegedly false or misleading statements were made. "Plaintiffs are purchasers of the common stock of JDSU" (Pet. at 1), while the allegedly misleading statements made by Nortel were "positive statements concerning *Nortel's* operations and prospects" (Pet. at 2) (emphasis added). The practical impact of the Opinion will not be to handicap legitimate securities plaintiffs, but rather to confine plaintiffs to seeking relief only for misstatements made about securities that they actually purchased.

Thus, if a broker lies to a customer about stock X and the customer buys stock X, nothing in the Opinion speaks to that customer's standing to pursue a claim against the broker. Similarly, the Second Circuit has recognized that brokers, accountants, underwriters and banks may indeed be held liable under Rule 10b-5 for statements made regarding a security other than their own; nothing in the Opinion will alter that law. The only requirement is that the class of putative plaintiffs must be limited "to those who have at least dealt in the security to which the . . . representation or omission relates." App. 10a (citing *Blue Chip*, 421 U.S. at 747).[8]

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[8] It is only through plaintiffs' own strained construction of the Opinion that the specter of unfairly precluding various types of legitimate lawsuits arises. The phrase "material misstatement of another company" (App. 13a) in the Second Circuit's holding is properly construed to mean a material misstatement *regarding* another company, as opposed to plaintiffs' view that it refers to a material statement *issuing from* another company. Of course, under either reading, plaintiffs here are properly deprived of standing.

Certiorari is therefore not warranted to resolve plaintiffs' speculative and hyperbolic concerns, which are purely a red herring. Here, plaintiffs are, indisputably, "nonpurchasers" of the Nortel stock to which the alleged misstatements relate, and thus they clearly lack standing to pursue their claim against Nortel.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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